

MEKONG ECONOMIC RESEARCH NETWORK

Improving Local Participation in the Garment Industry of Cambodia

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1. Background and Rationale

Since the enactment of its Law on Investment in 1994, Cambodia has attracted the inflow of foreign direct investment mainly into the garment industry, which has served as a major pillar of economic growth since then. A direct contribution of garment industry to GDP peaked during mid 2000, representing about 15%¹, and is now still remaining 10%, which is a significant share. The export value of the industry represents around 75% of the total foreign exchange earning². Despite so, participation of local investment in the garment industry remains limited. More than 90% of the investment in garment sectors is foreign direct investments³ and investors from Taiwan, Hong Kong, China, and South Korea dominate the industry.

After 20 years' time, it is now worthwhile to take stock and learn from past lessons in order to improve the local participation in the garment industry. The review will feature the progresses and challenges that local investment has encountered, and highlight opportunities for policy enhancement in order for local investment to play more and better role in the industry.

After 10 years of implementation, Cambodia's liberal Law on Investment got

¹ Neak, S. and Yem, S., (2006). Trade and Poverty Link: The Case of the Cambodian Garment Industry. Phnom Penh: CUTS and Economic Institute of Cambodia (EIC)

² Garment Manufacturers Association in Cambodia (GMAC), www.gmac-cambodia.org

³ Ouch, C., Saing, C. and Phann, D. (2011). Assessing China's Impact on Poverty Reduction in the Greater Mekong Subregion: The Case of Cambodia. CDRI Working Paper Series No. 52. Phnom Penh: Cambodia Development Resource Institute (CDRI)

amended for the first time in 2003. It has been more than 10 years since then and Cambodia may again consider the amendment of the Law on Investment in the near future in order to reshape its growth structure and dynamics in response to changing global and local contexts. Therefore, the result of this study will be a timely and important piece of contribution to stimulate the discussion for policy consideration.

2. Objectives and Methodology

For the purpose of enhancing national policy to promote the local participation in the garment industry, this study specifically wishes to examine why there has been so little participation of local investment in the garment industry and explore what can be done to improve the local participation.

Toward these ends, the study takes a qualitative approach through both desk review and discussion with industry practitioners. Firstly, a review of existing policy documents, studies and reports related to Cambodian garment industry will establish an overview and historical development of the industry, and trace records of facts and findings that are pertinent to determinants of and constraints for emergence of local investment. Secondly, the study will hold face-to-face discussion with individual garment factories with aims to uncover more truth on the ground.

To ensure the relevance and quality of the data, the research aims to meet with senior managers of the factory. This is possible through collaboration with the Garment Manufacturers Association in Cambodia (GMAC). A checklist has been used to guide the discussion and it is a helpful instrument in two ways: i) help

ensure the structural capture and smooth flow of conversation; and ii) allow flexibility for the discussion to go deeper and embrace contexts and views that may vary from one factory to another as well as from one respondent to another. 15 companies were selected through consultation with GMAC and through snowball approach by requesting the respondents to suggest more companies that are relevant to the study.

Table 1: Profile of Interviewed Firms

No.	Country	% largest Share	Industry	Legal Status	Location	Year of Registration	# Employee (2013)
1	Bangladesh	100%	Woven Apparel	Subsidiary	Phnom Penh	1999	2240
2	Cambodia	100%	Embroidery	Unregistered	Phnom Penh	1999	120
3	Cambodia	100%	Woven Apparel	Sole Proprietorship	Phnom Penh	2007	110
4	Cambodia	60%	Woven Apparel	Sole Proprietorship	Phnom Penh	2009	450
5	Cambodia	100%	Woven Apparel	Sole Proprietorship	Phnom Penh	2013	160
6	Cambodia	100%	Woven Apparel	Sole Proprietorship	Phnom Penh	2005	560
7	China	100%	Knitted Apparel	Subsidiary	Kandal	2011	1200
8	China	100%	Woven Apparel	Subsidiary	Phnom Penh	2004	7000
9	Hong Kong	100%	Woven Apparel	Subsidiary	Phnom Penh	2000	1600
10	Hong Kong	100%	Woven Apparel	Subsidiary	Phnom Penh	2011	1270
11	Malaysia	100%	Woven Apparel	Subsidiary	Phnom Penh	1997	8130
12	Malaysia	100%	Knitted Apparel	Subsidiary	Phnom Penh	1992	6800
13	Singapore	55%	Knitted Apparel	Subsidiary	Phnom Penh	2010	1613
14	Taiwan	51%	Knitted Apparel	Subsidiary	Phnom Penh	2005	7050
15	USA	100%	Woven Apparel	Limited Partnership	Phnom Penh	2010	450

Of the 15 firms interviewed, one third are Cambodian owned. The rest are owned by investors of other nationalities, including Bangladesh, China, Hong Kong, Malaysia, Singapore, Taiwan, and the USA. Most of these firms are producing woven apparel. Only 4 of them are knitted apparel makers. Of Cambodian owned firms, one is an embroidery service provider; the rest are woven wear makers. The selected companies are combination of ones that have just started business activities in more recent time and those that have started operations since early 1990s and later.

3. Performance and Trends of the Garment Sector

Amidst an impressive growth rate of approximately 7.5% per annum on average in the past 15 years, the overall structure of Cambodia's economy has not marked a significant change. The service sector has been dominant while agriculture stayed around one third of GDP for about 15 years and the industrial sector remained the smallest albeit becoming more important. According the national account, the industry sector represents 22% of the total output in 2012. Non-manufacturing is roughly one third of the total industry output, in which garment and footwear are undoubtedly outstanding, followed by food, beverage, and tobacco. Figure 1 provides the details.

After 20 years' time, the garment industry still has not developed substantial linkages to the host economy. The industry operates almost like an enclave one, except for its provision of low-wage employment to abundant unskilled labor force. Nearly all the factory projects are wholly FDI. Almost 100% of raw materials and intermediate inputs are imported. Forward linkage within the domestic economy is virtually an absence because the industry is primarily for export, rather than for import-substitution.

3.1. Evolution of the Garment Industry

The current garment industry in Cambodia began around 1994, following the secure of peace and stability through the first general election in 1993. The industry has become a predominant feature of Cambodia's manufacturing as well as the whole industry sector. It was investors from Hong Kong, Taiwan, Malaysia and Singapore who operated the export-oriented garment factories.

The number of garment factories increased from just 20 in 1995 to 426 in 2013. The Taiwanese-owned factories are highest in number, followed by Chinese and Hong Kong. As reflected in conversation with CEO and senior managers of the companies, the motivation for these export-led garment factories to locate their business in Cambodia is not at all to do with availability of inputs domestically, but investment incentives from the host government, duty and quota exemption from export markets such as the US and the EU, and cheap labour. That clearly reflects the growth of the industry over time since its commencement.

As a supporting legal framework for the industry, Cambodia promulgated the Law on Investment in 1994. The law was meant to attract the inflow of foreign direct investment into the country through the assurance of confidence and provision of investment incentives such as: i) reduction of corporate tax rate to just 9%; ii) exemption of corporate tax up to 8 years; iii) 100% exemption of import duties on the construction materials, production equipment, and inputs; iv) 100% exemption from export tax; v) no taxation on the distribution of dividends, profits, and proceeds of investment; vi) no restriction on the repatriation of profit and currency conversion; vii) 100% foreign-owned firms are allowed; viii) foreign firms are allowed to own up to 49% share of the land serving the purpose of investment activities; and ix) foreign firms can employ foreign nationals if skills and expertise are not locally available.

At an institutional front, the Law on Investment in 1994 established the Council for the Development of Cambodia (CDC) as the highest decision-making level of the government for the private and public sector investment⁴. It is chaired by the Prime Minister and composed of senior ministers from

⁴ <http://www.cambodiainvestment.gov.kh/about-us/who-we-are.html>

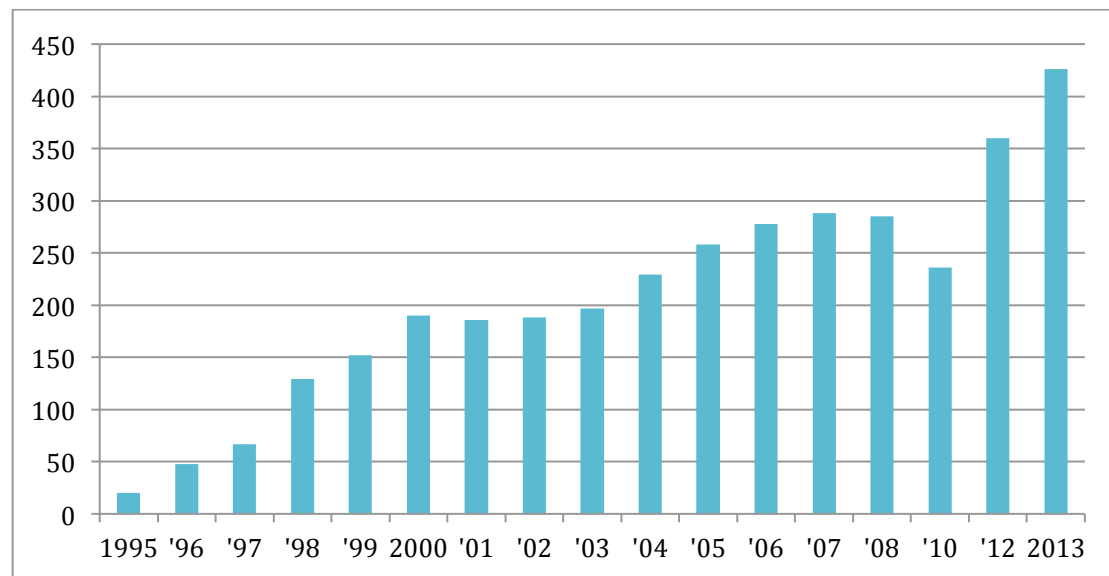
related government agencies. The Cambodian Investment Board (CIB) and the Cambodian Special Economic Zone Board (CSEZB) are the CDC's operational arms for private sector investment. CIB deals with investment projects out of special economic zones (SEZs) and CSEZB takes charge of investment projects in SEZs. They review investment applications and grants incentives to investment projects meeting the requirements laid out in the Investment Law.

For coordination efficiency as well as to groom a self-institutionalized industry, the government encouraged the creation of factory associations and trade unions. The Garment Manufacturers Association in Cambodia (GMAC) was established in March 1996. By June 2013, GMAC members include 426 garment factories and 47 footwear factories. Since its establishment, GMAC has worked to serve its members and also contributed to the development of the garment industry, for instance, through policy advocacy with relevant institutions both locally and internationally.

After 10 years, the law on investment was amended for the first time in March 2003. The amendment abolished a provision on the reduction of the corporate income tax rate and the entitlement of foreign firms to land ownership, but overall the new law has remained open and generous for investors. The new law seeks to further improve the investment climate and procedure. The government committed to improve the efficiency of its services, particularly the one-stop service investment promotion agency at the CDC. The procedure to get the approval of the investment project was more explicit and less discretionary. Rather than listing all sectors open for foreign investment, a negative list is instead provided by specifying the types of businesses ineligible for the incentives. Moreover, the new law extended the investment incentives to domestically oriented investment and industries that support the export firms. Of note, despite the new law, the government

continued to offer some special treatment to the investors, for instance, the granting of additional two year tax holiday to 180 out of 270 garment factories in 2006 (Ear 2011, cited in Asuyama and Neou 2012).

Figure 2: Number of Export-Oriented Garment Factories in Cambodia



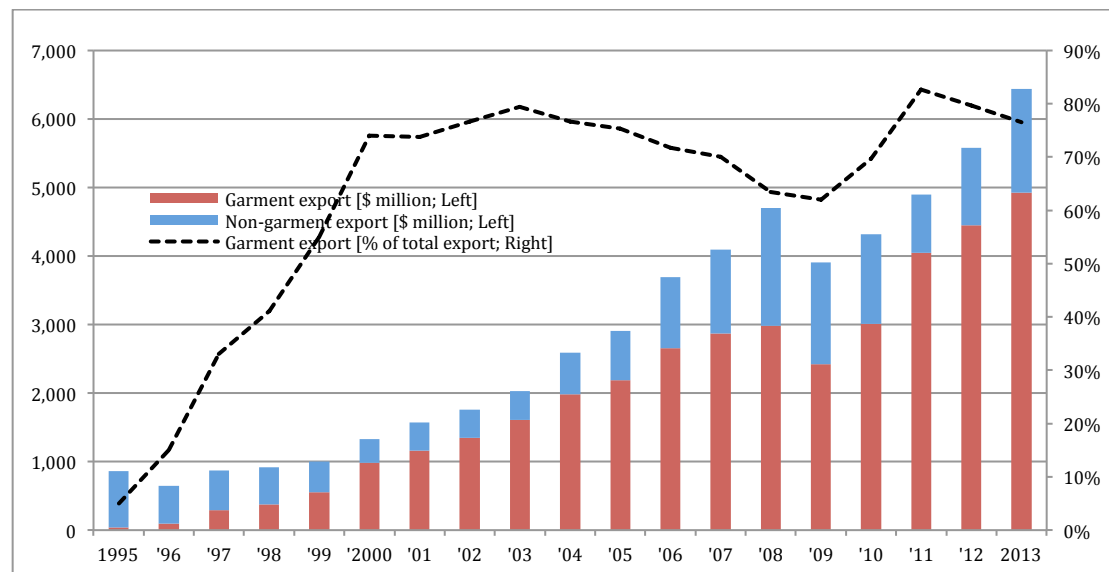
Source: Authors, based on GMAC (2012, 2013), Natsuda et al (2009), Neak and Yem (2006)

As indicated in **Figure 2**, the increasing number of garment factories is in line with the major milestone of the industry evolution has described above. During the early 1990s, the increase was mainly driven by the favourable policy of the local government. During the second half of 1990s, a sharper increase was attributed to the offer of MFN and GSP status from the US and the EU in 1996. The number of garment factories increased from 20 in 1995 to nearly 50 in 1996, and then to 152 in 1999. The post period of the quota imposition by the US in 1999 is marked by a stagnate investment, but Cambodia's accession to WTO in 2004 had attracted more investment into the industry and has kept its export sector, particularly the garment industry, remain relevant and competitive in the world market. Then, the number of garment factories declined during the global economic downturn, but soon bounced back after the crisis. The rise of the garment factories during the post-crisis period is more explained by the reallocation of factories from China that has faced wage increase.

3.2. Production and Export

From its commencement in 1994, the garment industry was export-oriented. The share of garment export was just about 5% of the total export in 1995, but soon the earning from garment export double to nearly \$100 million in 1996 and then saw a triple increase to nearly \$300 million in the following year. Within the first five years (1995-2000), the garment export experienced a 23-fold increase to nearly \$1,000 million. The increase continued over time and reached about \$5,000 million export in 2013, except a drop in 2009 due to the impact of the global economic downturn.

Figure 3: Garment production and export



Source: Authors, based on MEF (2010), GMAC Website, and Neak and Yem (2006)

Overall, the garment production and export has expanded around 30% per annum between 1995 and 2013. The growth rate is nearly three times faster than that of the total export. The growth of the garment production and export can be classified into three phases. The industry experienced an exponential growth during the early stage. The production and export expanded 87% per annum between 1995 and 2000. Such exceptionally high rate of export increase partly reflects the infant stage of the industry with low base of production and export. After that the growth rate was such slower, around 15% per annum during 2000-2008. Of note, this period is marked by a slower growth rate of the garment export than the expansion of the total export. However, the export quickly bounced back in the post-crisis period and achieved a growth rate of around 19% per annum between 2009 and 2013.

Table 2: Expansion rate of the garment production and export

	1995-2000	2000-2008	2009-2013	1995-2013
Annual growth of total export	9%	17%	13%	12%
Annual growth of garment export	87%	15%	19%	30%

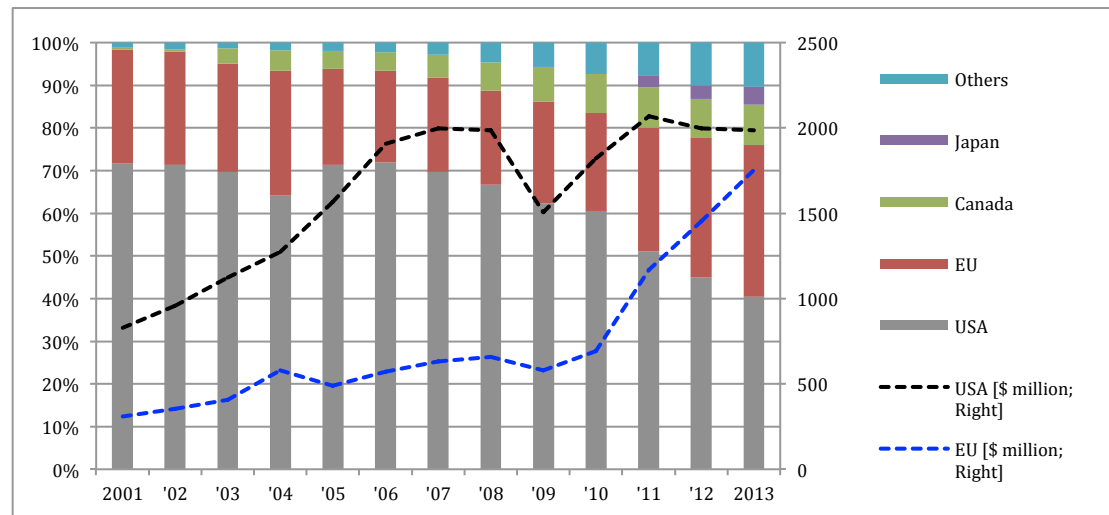
Source: Authors, based on data from MEF and GMAC

The three phase of growth of garment export well reflects the share of garment export out of the total export as illustrated in **Figure 3**. The share of garment export was just around 5% of the total export in 1995, but rose sharply to nearly 74% in 2000. The share then remained stable around 75% during early 2000s and then came through a declining trend during 2003-2008 although the level of production and export continued to expand. This suggests that the export of products other than apparels was gaining good momentum. Although the share of garment export rose sharply after the crisis, it started to decline again in 2012 and 2013, again suggesting a faster growth of non-garment export from Cambodia.

Over time, Cambodia has diversified its export markets although the pace has not been swift. **Figure 4** illustrates a structural change of the market destination for Cambodia's apparel export. In the past, the garment product was almost entirely dependent on markets in the US (more than 70%) and the EU (nearly 30%). The export to Canada became more significant since 2003, accounting for about 4% of the total garment export and increased to nearly 10% in 2013. The export to Japan also became more sizeable since 2011, accounting for 3% of the total garment export and increased to more than 4% in 2013. The size of other markets has also expanded over time. In contrast,

the share of garment export to the US market has declined to just 40% in 2013 while the EU market has absorbed more and more garment products from Cambodia. The EU is now responsible for 35% of Cambodia's garment export, nearly the size of the US market.

Figure 4: The garment and export markets



Source: Authors, based on data from MEF (2010), GMAC Website, and Neak and Yem (2006)

4. Challenges for the Emergence of Local Participation

Since its inception in early 1990s, the structure of the garment industry has remained more or less unchanged. The industry has largely dominated by foreign investment from Hong Kong, Taiwan, China, South Korea, and others. The proportion of Cambodian owned factories was 11% as of 2000 (Bargawi, 2005). A later source indicates that the share of Cambodian owned factories was roughly 5% as of 2010 (Ouch et al, 2011). The trend doesn't even show a positive progression while the share of Cambodian investment could be even further less given expected smaller size of Cambodian owned factories in

relation to its foreign owned counterparts. However, GMAC has noted more participation of Cambodian owned firms in recent time.

Across the discussion with both local and foreign practitioners in the garment industry, the challenges for the emergence of the local participation in the garment industry in Cambodia are attributed to a number of factors that can be broadly organized as: skills, technology transfer, credits, home market, market access, and state intervention. These factors are interrelated and work in combination to undermine the emergence of local investment.

4.1. Low Skill Base

Although garment industry is a major pillar of its economy, Cambodia does not have a university or a college providing related skills to supply human resources for the industry. The presence of technical skills training centers related to apparel making is also almost unobservable. GMAC has tried to provide training courses to improve the skills of the workforce, but its scale is still limited. Such has left the whole industry reliant on skill import. According to a survey cited in Goto (2010), Chinese human resource agencies supply approximately 5,000 Chinese garment technicians and supervisors to garment factories in Cambodia. A branch of a foreign company who supplies industrial sewing machines to around 250 garment factories in Cambodia noted that most of the technical focal persons of the factories it works with are Chinese.

Given no domestic human resources to substitute all these imported skills, Cambodia has foregone an ample opportunity to earn income. As a result, those skills have remained in the control of foreigners and that has been an

important factor undermining the emergence of local participation in the industry.

While skill training and development related to garment making in particular is almost none, the promotion of science studies in general such as mechanics and manufacturing at higher education is also pointed out as weak. It was reflected that the number of graduates in science is proportionally low with loose quality. Although scholarship for overseas degrees have been offered by other partner countries, Cambodia doesn't seem to have a clear cooperation to get more skills for this important industry of its economy.

4.2. Meager Technology Transfer

According to Cambodian owners of garment factories, the degree of technology transfer from foreign invested companies is almost unidentifiable, except some from Japanese companies and through individual talents and opportunities. Such meager technology transfer to the local is subject to three major factors: i) low absorption capacity of the local; ii) tight restriction of transfer by foreign companies; and iii) no favorable government intervention and policy.

Low absorption capacity of the local

While lack of tertiary education and training centers providing garment related skills determine Cambodia's low skill base, low education attainment among Cambodian workers in general hinders their ability to absorb technical and managerial skills. As the empirics shown, the extent of spillover is closely related to the domestic capacity to absorb advanced technology or positive

spillover of FDI is more positive when the local workforce possesses higher absorptive capacity (Borensztein et al 1998, and Barrios and Strobl 2002, cited in Cuyvers et al 2008). As of the academic year 2012/13, Cambodia's net enrolment rate for lower secondary school was only 37.8% (Naron, 2014), let alone the completion rate and poor quality of student learning outcome.

Through interviews with senior managers, foreign owned factories have not observed any of their former employees acquired the skills and able to run their own businesses in the garment industry. If it is the case, they are usually the Chinese people who left the company and run their own business as sub-contractors. Although the respondents are not a representative sample, GMAC confirms that very few, if any, have acquired the skills through their employment. According to those who are familiar with garment sub-contracting industry, the number of sub-contractors of apparel making and embroidery enterprises ranged from 100 to 200; Cambodian owned enterprises are around 15-30, the rest are mostly, if not all, Chinese.

Due to no acquisition of skills through employment by local workers in the foreign companies, technology transfer to staff turnover is obviously not reported.

Tight control of technology transfer by foreign companies

From their observation and experience, owners of locally owned factories, who have experienced and are familiar with the garment industry, share their consent that foreign companies in general is holding a very strict control of their production technology. They have no plan to transfer the know-how at all. Of note, respondents from foreign invested companies do not report on any deliberate skills transfer and are not generally aware of any spillover of

technology transfer to the local through employment. Only Japanese firms who are keen to transfer technology when they work with their local business counterparts. Apsara Garment Co., Ltd., for example, is enjoying technology transfer from its Japanese buyer over 7-year contract period. Koreans are also perceived to be more responsible for the technology transfer than other foreign investors.

Cases in box 1, 2, and 3 demonstrate a few rare cases among Cambodian workers on how they have acquired their skills in the garment sector through their direct and indirect engagement. Their skills were attained more through their talent and diligence rather than attempt of the companies. Mr. Khov Chhay of Apsara Garment Co., Ltd. (Box 1) acquired his technical skills from his training career with a USAID-funded project. Mr. Bora of Liya Embroidery (Box 2) had learned the mechanic skills from his Japanese firm. Ms. Chot Bopha of First Fit Co. (Box 3) benefited most of the skills from her 8-year employment as a line production manager with a South Korean firm.

Box 1: Apsara Garment Co., Ltd.

Mr. Khov Chhay is a successful Cambodian businessman in the garment industry. He is now a Managing Director and owner of APSARA Garment Co., Ltd. He used to work as admin assistant and assistant to GM with a Singaporean company where he got to learn about the industry, but admits that most of his knowledge and skills that have enabled his business career were acquired from his affiliation with the Garment Industrial Productivity Centre, a USAID-funded project working on garment productivity improvement, where he worked as a trainer of industrial engineering and a

technical manager. He has later further benefited from direct relationship with a current Japanese buyer, who agreed to provide technology transfer.

After leaving his full time job with the Garment Industrial Productivity Centre, Mr. Khov Chhay started his own account tailor shop of 10-20 sewing machines in 2008. His saving and fund support from his family are major financing sources. His shop supplied uniforms and other promotional apparels the local market. The business was later expanded with around 50 sewing machines and provided sub-contracting services to bigger garment factories on an ad-hoc basis. With earned profit and plus bank financing, the business capacity expanded to around 300 sets of sewing machines in 2009. It started to have connection and cooperation as sub-contractor with big foreign invested companies from China and later Taiwan. In 2010, a Japanese firm who was in search for local partner made a visit and spent nearly two years to study the cooperation possibility. In 2011, APSARA Garment Co., Ltd. secured a 7-year cooperation agreement with the Japanese firm, who is the buyer. Successful cooperation with the Japanese company has opened up more cooperation from other clients from Thailand and other countries.

It is important to note that the tight control of transfer well reflect the historical development of the garment industry globally and regionally. When the production base of garment industry was shifted from North America and Western Europe to Japan during he 1950s and 1960s, the technology transfer accompanied the shift. And it was the same phenomenon of technology transfer when the production base moved from Japan to Hong Kong, Taiwan, South Korea, and Singapore during the 1970s and 1980s. After that, the four countries managed to control the technology through their invention of “triangle manufacturing” initiative, in which they receive orders from their

traditional buyers in the west and then place some or all of those orders to their subsidiaries or other affiliated partners in low-wage economies in the region. Finally, the ready-made garment will be directly transported to the buyers.

No favorable government intervention and policy

Low absorption capacity of the local and restriction of transfer by foreign companies carry their weight in limiting the technology transfer, but the role of the government was pointed out to be another critical factor. The respondents find Cambodia's policy to attract foreign investors is so open and generous, but it hasn't had clear policy instrument and plan to get those skills transferred to Cambodian workforce. That doesn't fully limit the transfer, but it would have worked better and faster if properly planned and managed. For instance, despite tight control of technology by the parent companies, the Cambodian respondents pointed out that China and Vietnam have had good record of technology transfer.

4.3. Mismatch of Demand for Skills and Capital

While there are shortages of skills among Cambodians and non-deliberate transfer of skills and technology, the availability of skills is not completely none. There is indication suggesting Cambodia have actually learned and accumulated the know-how in apparel making, though not at a significant scale. According to owners of some Cambodian factories, there are actually more Cambodians who have improved their skills and picked up technical and managerial positions in various factories. A survey of 164 garment firms in

Cambodia by Yamagata shows that 8% of top managers were from Cambodia although other 30% of top managers were from China, 21% from Taiwan, and 15% from Hong Kong (Goto, K. 2010). Another sample survey⁵ indicates that 14-15% of the workers are likely to use their knowledge and skills to run their own business such as tailor shops; other 6-8% hope to get employed in similar factories in other countries such as Korea, Malaysia, and Thailand (Ouch et al, 2011). This may imply that some technical and managerial staff are performing their jobs well and thus expect chances to work with overseas subsidiaries.

Where there exists skills necessary to participate in the garment making, Cambodian practitioners find the challenge rests with access to capital. The skilled employees do not have capital base to start their venture. Meanwhile, it is also acknowledged that those who own the capital do not have necessary skills in the industry; and the two are not met up, a situation in which Cambodian entrepreneurs described as non-existence of double coincidence of demand for skills and capital: those who have learned the know-how do not have the capital while those who have the capital do not have the know-how. More importantly to note, the capital owners are not so interested in the garment making business because there still exist opportunities to earn easier money, which are more attractive and less diligent.

Due to their limited capital, Cambodian entrepreneurs have to go through a longer and harder process to start and grow their businesses. Usually they got their capital from their limited savings and borrowings from relatives and friends. In the case of Liya Embroidery Co. (Box 2), Mr. Bora got his business of just two embroidery machines financed by the sale of his apartment plus his

⁵ a survey of 300 garment workers, which include quality control workers, quality control inspectors, final inspectors, mechanic, quality assurance assistants, and office staff.

savings and supplier credit from a Japanese company that he had built the relationship and trust. In the case of Apsara Garment Co., Ltd. (Box 1), the owner started a tailor shop of 10-20 sewing machines financed by his savings and co-fund from his brother.

Box 2: Liya Embroidery

Mr. Bora of Liya Embroidery. Mr. Bora virtually accumulated his skills through working with a Japanese firm supplying embroidery machines for garment factories, coupled with his observation over embroidery business operation in the garment sector. He got his mechanic skills enhanced and observed how embroidery businesses work during his contact with factories, who were clients of his company. He worked out the cost and benefit analysis and made business plan for his own. In 2001, he managed to run his own embroidery business with just two machines with financing from his savings, sales of his apartment on 2nd floor in Phnom Penh, and supplier credit from the embroidery machine supplier that he worked with. While running his own account business, he was also continuing his job with the company until 2008 when he resigned from his position as a manager. His business expanded to 12 machines and later 22 sets in 2006, working as sub-contractors for 3-4 garment factories.

Despite many years of success experience, the business is now under threat of competition from the Chinese counterparts. The company has been rather stagnate in recent years and he is a bit pessimistic that the Chinese owned enterprises might drive Cambodian firms out if the government doesn't enforce the playing field. The government should have effectively enforced the leakage of machineries imported by the main companies, in his view.

4.4. Low Access to and High Cost of Finance

There has been quite significant improvement in the financial sector of Cambodia. Financial service has been more widely available and the interest rate has seen a gradual reduction. Nonetheless, Cambodian entrepreneurs still find the accessibility remains low while the cost of finance is still relatively high to borrow. As a case in point, Ms. Chot Bopha of First Fit Co., Ltd. (Box 3) had limited capital to finance the start-up investment of her business and she had to take out loan from a commercial bank, but it was not so conducive. While the interest is a bit high for her to run a risk, her USD 70,000 worth house could only back her as collateral for just USD 20,000 loan. Although the financial service is widely available, she found she could not get as much out of her collateral. It should have been easier for her business start-up if she could have higher degree of access to that financial service.

Box 3: First Fit Co., Ltd.

Ms. Chot Bopha, a 31-year-old single woman, is among rare examples of spillover of technology transfer in Cambodia's garment industry. Ms. Bopha is now running her own account sub-contractor of apparel making, First Fit Co., Ltd. She had learned the know-how mostly from her 8-year experience with a Korean garment factory, where she was promoted to be a line production manager. She started her job in the garment factory upon finishing her high school in 1999. She had also worked for Chinese and Taiwanese factories, but

found the Korean firm was the one responsible most for all her knowledge and skills to run her own account business today.

First Fit Co., Ltd. has just started its operation in April 2013. The start-up capital was USD 110,000 and the owner got financing from her saving and borrowings from friends, relatives, and a bank. In terms of market access, she got the assistance from her foster brother who helps connect with the garment factories. The piece-rate system allows First Fit Co., Ltd. to attract highly performing workers from FDI factories. The young owner has great confidence in running the business, as she trusts her talent, skills and experience. She is confident that her production techniques and processes could yield a 40% higher output than the competitors in the case where machineries are comparable. Although, she bears higher cost, for instance, by having to pay higher wages, she could still enjoy a net efficiency gain of about 30% more than usual factories thanks to her daily own close supervision.

4.5. Garment is Not a Locally Developed Industry

It is important to note that the garment sector of Cambodia is not a phenomenon of industrialization that is rooted from a locally grown industry and it is wholly for export purposes, rather than to supply the local market demand by substituting the imports.

The respondents generally agreed that Cambodia's apparel industry is not a locally born and developed industry, in which local skills exist and accumulate over time. Instead, it is mainly invested and developed by foreign investors who brought in all necessary inputs and production technology. Before the

presence of the garment industry from early 1990s, Cambodia itself has never had an industrial scale of apparel production. There were only small-scale tailor shops to supply the part of the local demand. Most of the local market demand was actually supply by the imported clothes.

Small Size of Home Market

The stories of having no industrial scale of local garment producers and of dependency on imported clothes were further attributed to effect of the home market size and globalization. Both factors actually work in combination. On one hand, relatively small size of domestic market hinders the local garment making to become on an industrial scale. A country of 14 million population, or even much less before, with large majority having no purchasing power for such garment products made the market too small. None of the respondents find their choice of Cambodia as production base was nothing to do with expectation of increasing customer base for their products in the host country, but tax incentives from the host government, cheap labour, and duty and quota exemption from major export markets such as the US and the EU that take up 75% share of the total export. On the other hand, Cambodia's integration into the global market plus its open trade policy easily allows the inflow of clothes from countries who have already competitiveness in industrial garment production.

Given small size of the home market, none of the foreign investors cited their selection of Cambodia as the production base was motivated by prospects to secure the market capture. That's why none of the foreign and Cambodian owned firms are interested in supplying the local market. They export all their products. Their investment in Cambodia was reportedly to have driven by market access to the US and the EU through tax exemption and quota free;

favourable investment policy offered by the Cambodian government especially exemption on corporate profit and import duties of inputs, equipment, and construction material; and abundance and low cost of Cambodian labour.

Lack of Supporting Industry

Lack of supporting industry, which is underpinned by low or even no factor of endowment, also partly undermines the emergence of local industry. The views of the respondents also pointed out that the absence of the supporting industry, especially the supply of major inputs, is to some extent explaining low participation of local investment in the garment sector. That relates most to the skill and technological development. If there existed textile industry locally, for example, Cambodia would somehow be able to accumulate their learning curve and absorb new technology that would potentially enable its local investors to expand their vertical business chain. Although Cambodia has its own traditional weaving, but that has never been industrialized. Moreover, Cambodia used to have its own textile industry during 1960s, but it was vanished since 1970s wartime.

Although Cambodia's garment industry was established since early 1990s, the presence of local upstream sector is not observable, especially no availability of raw materials and other domestically produced intermediates. All the raw materials and most of the intermediate goods are imported and estimated to be around 55% of the FOB cost. A survey by JETRO (2013) on Activities of Japanese Manufacturing Companies Operating in Asia and Oceania found that the support of domestic production to FDI is exceptionally weak in Cambodia. Only 2.2% of raw materials and spare parts could be procured locally,

compared with 18% in Laos, 24% in Bangladesh, 28% in Vietnam, 43% in Indonesia, and 53% in Thailand.

None of investors was seeking resources such as raw materials; instead, their main motivation of doing business in Cambodia was primarily driven by: i) market access to the US and the EU through tax exemption and quota free; ii) favourable tax exemption policy from the host government on corporate profit and import duties of inputs, equipment, and construction material; and iii) cheap labour. In contrast, investors find a number of critical challenges for their businesses such as high cost of infrastructure including electricity and transport, high informal fees, and the poor quality/productivity of labour.

4.6. Control of the Global Market Access and Value Chain

When the industry is becoming more and more globalized, both the upstream and downstream sectors of the industry rest in the control of the buyers and the parent companies who directly receive the orders from the buyers. Garment factories in Cambodia are generally foreign subsidiaries whose headquarters locate in Taiwan, Hong Kong, China, South Korea, Singapore, and Malaysia.

The downstream value chain is all the affair of between the buyers and the regional dealers (parent companies). Local subsidiaries and factories only perform a few functions such as sample production, sewing, finishing, and packaging. Most functions including product development/design, selling and distribution, and logistics are all beyond the affair of subsidiaries in Cambodia. Therefore, it is almost impossible for a local producer to have a direct access to the market. In addition, the placement of orders by the parent companies

gives high priorities to their subsidiaries. And given the fact that around 90% are garment factories in Cambodia are subsidiaries, plus no requirement of partnering with the local, the chance is almost impossible for the local investment to participate in the industry.

The upstream sector is also tightly controlled. Almost 100% of raw materials and intermediate inputs are imported. Responses across the interviews indicate that the type of raw materials, intermediate goods, and accessories are not generally decided by the factory or even the headquarters, but instead nominated by buyers.

The below case of Inter Hopewell Garment Co., Ltd. in Box 4 is an example demonstrating how a fully Cambodian owned factory who are fully reliant on the know-how from expatriates have tried, thrived, and strived in its business operation in less than half a decade period. Although the failure is not fully explained, it is still a case worth considering.

Box 4: Inter Hopewell Garment Co., Ltd.

Inter Hopewell Garment Co., Ltd. is a 100% Cambodian owned garment factory that was established in 2005. The owner is a daughter of a tycoon and she does not have garment related experience before starting the business, but she had experience in running other type of business. She hires technical experts who are usually Chinese and Taiwanese. Currently, there are 10 of them.

The business experienced a healthy progress in the early years. Initially, the factory was operated as a Cut and Make, but later expanded to be an FOB in

2006, which means the producing firms source fabrics and other materials by themselves. The company set up a representative/sale office in Hong Kong and the market destinations include USA (50%), EU (30%), and other countries (20%). The relationship with buyers has entailed technology transfer through provision of specification and training for technicians. A buyer that is responsible for such technology transfer is MANGO in Europe.

Inter Hopewell Garment Co., Ltd. has faced unfavorable business operations in the last few years. Its production experienced significant drops in the last few years. The interviewed staff could not elaborate the reasons underpinning the decline, but cited shortage of labor supplies and wage competition from foreign invested factories are partly a factor.

The origin and development of the garment industry in the region traced back to the period of more than half a century ago. The industry flourished in Western Europe and North America, but its development has remarked a significant change since 1950s when its production base was first moved to Japan (Bargawi 2005). Then the second generation of shift was the relocation of the production base from Japan to Hong Kong, Taiwan, South Korea, and Singapore during the 1970s and 1980s. The third shift followed in the 1990s when the production base was moved from these four newly industrialized economies to China and other nations in South and Southeast Asia.

The control of the value chain in garment industry that prevails today was remarkably shaped by the development of the industry during period of second shift of production base in the 1970s and 1980s. The newly industrialized economies – Hong Kong, Taiwan, South Korea, and Singapore –

managed to master and advance the production technology by moving from just a mere assembly⁶ of imported inputs to a full-package supply or OEM⁷ (original equipment manufacturing). Further, those newly industrialized economies managed to develop their own design and brand and thus moved to another production system type called original brand name manufacturing (OBM⁸) by producing and selling their own branded merchandise at home and abroad.

Later, the development of “triangle manufacturing” that allowed the NIEs to dominate the industry despite the third shift of production base occurred. Asian NIEs initiated the triangle manufacturing model by requesting its overseas buyers to continue placing orders with their NIE manufacturers; then NIE manufacturers will extend some or all of the orders to their affiliated offshore factories⁹ in low-wage countries while the finished products will be shipped directly to the overseas buyer (Gereffi and Memedovic, 2003).

More importantly, as cited in Fukunishi, T (2010), Gereffi and Memedovic (2003) noted that the consumer taste in modern time has changed very quickly and the capture of such preference information is in the hand of the big retailers/buyers who have sophisticated system to assemble information every efficiently and effectively.

⁶ is a form of industrial subcontracting, in which garment sewing plants are provided with imported inputs for assembly, most commonly in export processing zones (Gereffi and Memedovic, 2003)

⁷ a type of production system, in which the supplying firm makes a product according to a design specified by the buyer; the product is sold under the buyer’s brand name; the supplier and buyer are separate firms; and the buyer lacks control over distribution (Gereffi and Memedovic, 2003)

⁸ is the upgrading by manufacturers from the production expertise of OEM to first the design and then the sale of their own brand products (Gereffi and Memedovic, 2003).

⁹ offshore factories can be wholly owned subsidiaries of the NIE manufacturers, joint-venture partners, or simply independent overseas contractors.

4.7. Absence of Favorable Government Intervention and Policy

Last but not least, respondents from both foreign and local factories blame the absence of intervention from the local government as a crucial factor undermining the participation of local investment in the garment industry. Intervention from the government is desired, but not at all found in the areas of skill development, credit access, business operation, and market access. There is justification that Cambodian government and policy treats both local and foreign investors equally, but business practitioners augured that such equal treatment clearly means unfair treatment or unlevel playing field for local investors because foreign investors are already way more advantageous, for instance, in technology, efficiency, credits, and market access.

In an attempt to attract large number of foreign investors to help provide employment to the largely unskilled and abundant labour force, Cambodia's investment law was made very liberal in 1994. On top of its generous provision on tax exemption for foreign direct investment, the policy does not require a Cambodian share in the investment project. This means foreigners can have full control of up to 100% investment share. Such policy allows foreign investors to work without local partners and it is a chief factor explaining the resulted low participation of domestic investment. In the cases where Cambodian take is positive, its share appears too small to matter. Plus no proper management of technology transfer, the spillover of know-how through such co-investment scenario is barely possible.

While education and skill base is low, the government hasn't had specific intervention to prepare and nurture its labor force for the structural changes of the industry. A foreign respondent asserts criticism for the local government for such intervention and strongly suggest the local government

should learn the experience from Singapore and Malaysia in that regard. There are lessons to be learned out there to see how both countries managed to adapt to changes of the industry. He said it is inevitable that labor cost will rise over time and the industry will definitely have to move on, but the country must be ready for such change.

Although financial sector in general has improved over time, it remains one of the challenges for business enterprises, especially the local one. Clearly, Cambodians who have acquired the skills and are now participating in the sub-contracting service for the garment industry are in need for capital and credits to finance their venture and operation, but the government hasn't had any instrument to facilitate that dynamics, for instance, through special credit programs, seeds funds through competitive business plan, and so on.

Another obstacle for local business to emerge is the tax burden. Domestic firms are subject to all kinds of tax, while large foreign firms are not. Hence, most domestic firms stay informal in nature, which means they are unregistered. Therefore, they are not exempted from tax for their purchase of imported machinery/equipment as well as other intermediate materials. In the event that domestic firms are formal, they are further constrained by the formal tax regime, which includes 10% VAT, 1% turnover tax, salary tax up to 20% and 20% profit tax. In some instances, VAT is to be refunded, but in practice it takes years to claim that tax credit back and only a partial amount is usually returned. Foreign firms could better afford all these related costs, if any, because they have enjoyed other competitive advantages in their business operation. All these instances make local investment barely limited, if not impossible, in the garment industry.

On the other hand, Cambodian sub-contractors face tough competition with their foreign counterparts. Cambodia-owned firms are generally informal (unregistered) and thus are disadvantaged in terms of having no access to concessions such as tax-exemption for imports of their machineries, equipment, and raw materials. On the other hand, the sub-contractors that are owned by the Chinese dominate the market and often receive favouritism (Chinese assist Chinese) from large garment factories that are Chinese owned. The story goes as the large Chinese factories import their tax-exempted machineries; then discharge those machineries for other Chinese sub-contracting firms. This makes the Chinese sub-contractors more competitive. Moreover, the Chinese FDI favours sub-contracts with other Chinese as priority while Cambodian sub-contractors mostly get the overflow. Also, Cambodian firms face competition for labour from foreign-owned firms as the latter generally can afford to pay higher wages.

On the market end, respondents from Cambodian owned factories complaint that they had received no assistance or even special attention from the government for the market connection. Their criticisms were also extended to GMAC for it works to serve more the interest of foreign companies and pays little attention to local investment. That reflects the fact that the GMAC membership is largely dominated by foreign investors and thus challenges of local investors turned neglected although raised. In this regard, local investors should not highly expect the issues that are specific to them would be addressed by GMAC mechanism.

5. Conclusion and Suggestion for Policy Consideration

Given insignificant size of local participation, CEO and managers of foreign owned garment factories hardly identify Cambodian owned firms from their memories. They don't even find these local firms, if any, as their competitors or sign of future threats.

Due to high operating costs related to energy, transport, corruption, and productivity, foreign investors find Cambodia less competitive in the region and thus describe Cambodia's apparel industry as an overflow from other countries. More interestingly, they, in the same line, see Cambodian owned garment factories more or less as receivers of orders overflowed from local subsidiaries of foreign companies.

Views from Cambodian practitioners who have long involved in the industry found there had been increasing number of local firms entering the business venture into the industry since mid 2000s despite their awareness of non-conducive conditions and environment. And through their experience, they are less optimistic for further expansion of Cambodian representation because the current business environment is very challenging for them. Some are even likely to die out in a foreseeable future if no assistance or intervention from the government. All in all, representation of local investment is and will remain insignificant. Such low participation was explained by a number of factors as presented in the above findings including low skill base, meager technology transfer, mismatch between demand for skills and capital, low access to and high cost of finance, nature of the industry within the context of highly globalized environment, control of global value chain, and absence of favorable government intervention.

Consequently, there present rooms for Cambodia to benefit more from its garment industry. The share of Cambodian participation can be scaled up if all

above impediments are taken into account and addressed. Discussion with respondents through out the interviews suggest the following consideration:

(1) Because the garment industry has been so much reliant on imported human resources for technical and managerial positions, there presents ample room for Cambodia to harness the benefit. Introducing a program to groom the local capacity for that specific need could be a quick win over the short- and medium terms. For practical application, those to be trained workforce have to be skillful and more competitive than the imported ones so that they are attractive to investors. Such program may require close partnership with garment factories, especially for their cooperation to provide resource persons for the training program and on-site (on-the-job) internship for trainees.

(2) Given the fact that there already exist investors, particularly Japanese firms, that are keen for technology transfer, the government should closely look into that and secure a more systematic collaboration with them. This means Cambodia should meanwhile target strategic partners amid effort to diversify its export markets. As praised by the business practitioners, Japanese investors and buyers are most responsible for the technology transfer because they highly value the product quality and seek long-term investment and business partnership. Therefore, Cambodia would stand to benefit a lot in the form of technology transfer for improving participation of local investment if there is more presence of Japanese investors and buyers in the garment industry. Bilateral business and trade link with Japan deserve high priority so that the Cambodian economy can be quickly and strongly fostered.

(3) Over the long-term move, Cambodia must invest more efficiently and effectively in human capital development, especially through formal general

education system and tertiary education, in order to prepare itself for the structural changes of the whole industrialization process as well as within the garment sector itself. As pointed out by investors and lessons have shown in more advanced economies, labor costs will inevitably rise and the industry will definitely move on, especially to lower-wage destination. However, if Cambodia has adequate skilled labor, it would be able to stay relevant with higher-end apparel industry despite rising wage. So far, Cambodia's apparel industry is largely supplying low-end US market, which requires lower degree of quality assurance, and thus has had little result in technology transfer.

In complementary, higher-end garment product will entail more degree of technology transfer because it is relatively more complex in design and product specification and thus require high quality control. In turn it requires competent workers to absorb the know-how and perform more sophisticated equipment/machineries. It is hoped that such higher degree of technology transfer will consequently contribute to improving wider participation of local investment in the garment industry either at a higher- or lower-end markets.

(4) Improving cost efficiency and business environment in order to enhance competitiveness and attract responsible investors for high-end markets. To move up the value chain and stay relevant in a globalized world, Cambodia must tackle the impediments to its economic development in a fastest possible manner. Priority areas may include promoting the transparency and the rules of law, delivering efficient and effective government services, and reducing the costs of electricity, transport, finance, and informal fees. When all these elements are addressed, Cambodia will see more vibrant participation of local firms in the business value chain; at the same time, it can absorb sound investors for a more intertwined investment and business activities.

(5) To reduce unnecessary transaction for businesses and as well for burden for tax administration, VAT on capital goods that are clearly not for consumption should be automatically eliminated. Although the collected VAT is to be returned, businesses reported it took up to around 2 years and they never get full amount of tax credit.

(6) Under the current policy, only the qualified investment projects could benefit from 100% exemption on the import duties of raw materials, intermediate goods, construction materials, and production equipment. The government should consider removing levies for all capital goods, for example machineries, that are not domestically produced, so that the benefit is extended to the producer community wide. This way, local firms will also have access to the capital good and enjoy cost reduction without having to obtain qualified investment projects.

(7) To address what have been neglected by the past and current implementation, the government should study possible options to enable more local participation in the garment industry. As suggested by the business circle, the government can take into account the following:

(a) Establishing seed funds for business venture. Such funds can be provided on a competitive basis by inviting business proposals from young entrepreneurs. Provision of credit guarantee can be a viable option for local entrepreneurs in general.

(b) While seeking to reduce the overall cost of and access barrier to finance in the long run, a special or earmark financing scheme should be created for domestic enterprises in the garment sector.

(c) The government should introduce robust policy and plan for technology transfer from foreign companies. Measures may include improving Cambodian participation in foreign firms.

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